Internal Revenue Service

memorandum

CC:TL
Br4:HGSalamy

date May 6, 1986

to: District Counsel, Manhattan CC:MAN

from: Director, Tax Litigation Division

subject: [redacted]

This is in response to your request for technical advice dated April 29, 1986 in the above-entitled action.

ISSUES

1. Whether the Tax Court has jurisdiction in this I.R.C. § 7428 suit for declaratory judgment in that petitioner has failed to exhaust its administrative remedies as required by I.R.C. § 7428(b)(2) and, in any event, has requested relief which the court has no power to grant. 7428.00-00.

2. Whether this suit for declaratory judgment should be treated as one "involving a revocation" pursuant to Tax Ct. R. 217(a), permitting the parties to submit evidence in addition to that in the administrative record. 7428.00-00.

CONCLUSIONS

1. Petitioner has exhausted its administrative remedies insofar as its prayer for relief requests a declaratory judgment restoring its I.R.C. § 501(c)(3) status. While the court has no jurisdiction to declare the the so-called scholarships are not taxable under I.R.C. § 117, this request appears directly only as part of the prayer for relief. Rather then move to strike, we suggest that you argue the matter on brief. Thus, we agree with Proposed Position III in your April 29, 1986 request for technical advice.

2. While the final adverse determination letter does not use the word "revocation", it is clear that petitioner seeks restoration of its previously granted I.R.C. § 501(c)(3) status. The fact that the Service granted I.R.C. § 501(c)(9) status to petitioner from its inception is not a basis to consider this suit for declaratory judgment as involving an "initial qualification." This case is subject to Tax Ct. R. 217(a) and the parties may submit evidence outside the administrative record. Thus, we agree with Proposed Position II on this issue in your April 29, 1986 request for technical advice.

DISCUSSION

Petitioner's I.R.C. § 501(c)(3) status was revoked because it was not being operated exclusively for exempt purposes. As an employer-related grant making private foundation, it had to meet the eligibility requirements of Rev. Proc. 76-47, 1976-2 C.B. 670 in order not to be liable for the I.R.C. § 4945(a) excise tax for taxable expenditures. See I.R.C. § 4945(d). Because making the compensatory type grants was the petitioner's sole activity, it was issued a final adverse determination letter from which it timely petitioned the Tax Court.*/ During the examination, petitioner conditionally accepted its loss of I.R.C. § 501(c)(3) status provided the grants would not be taxable to the employee parents. These issues were considered in the National Office Technical Advice issued in this case (Exh. 44-AR to the Administrative Record) and resolved totally adverse to the petitioner. In that same advice, however, petitioner was accorded I.R.C. § 501(c)(9) status from the date of its inception pursuant to its formally filed Form 1024. With the condition unfulfilled, petitioner now seeks a declaratory judgment to restore its I.R.C. § 501(c)(3) status and prays, inter alia, that its grants be declared to be non-taxable under I.R.C. § 117.

The facts and law of these procedural issues were discussed in a telephone conference between Henry G. Salamy of this office and Kevin Reilly and Michael Goldbas of your office on May 2, 1986. With the administrative record as constituted and in view of EFCO Tool Co. v. Commissioner, 81 T.C. 976 (1983)(exhaustion requirement satisfied once IRS issues a final adverse determination letter), there is little likelihood that the court would hold that petitioner had not exhausted its administrative remedies. The final adverse determination letter issued to petitioner unequivocally rules petitioner to be non-exempt under I.R.C. § 501(c)(3) and acknowledge its right to file an I.R.C. § 7428 declaratory judgment suit to challenge the loss of that status.

As to the I.R.C. § 117 prayer for relief, we agree with you that it is objectionable. We believe, however, it would be best to address the matter on brief rather than move against that portion of the prayer for relief in the petition.

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*/ Rev. Proc. 76-47 cautions that operation giving rise to liability to for the I.R.C. § 4945(a) excise tax for taxable expenditures "might, depending on the circumstances, lead to a loss of private foundation's exempt status."

We cannot consider this suit for declaratory judgment as an "initial qualification" and prevent petitioner from introducing evidence outside the administrative record. First, while the word "revocation " was not used in the final adverse determination letter, petitioner does seek restoration of its previously granted I.R.C. § 501(c)(3) status. Second, the petition was treated by us as involving a revocation, entitling petitioner to the I.R.C. § 7428(c) protection for limited contributions made during the litigation period. See Announcement 85-169, 1985-48 I.R.B. 40. Lastly, petitioner could always seek to show "good cause" exists to supplement the administrative record, as provided in Tax Ct. R. 217(a). In view of the length of time petitioner's status was being considered by the Service and the multiplicity of issues arising form petitioner's operations, we see little point in not moving this case to decision as soon as possible. Arguments over procedural matters which will take time and resolve nothing meaningful are not in our best interest.*/

If you require our further views, please advise us. Your copy of the administrative record is returned.

ROBERT P. RUWE
Director

By: _____
HENRY G. SALAMY
Chief, Branch No. 4
Tax Litigation Division

Enclosure:
cc Adm. Record

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*/ The National Office Technical Advice concludes that the grants are taxable income to the employee parents. This ancillary issue is just as important to the Service as the issue of petitioner's I.R.C. § 501(c)(3) status.

HGS/kyj/5/6/86